

## Auditing

### Referral 5 - Solution



#### Question no 1

- a) The reasons that would support the auditor's decision not to use confirmations in this case are as follows:
1. The balance of receivables, as stated in the scenario, is immaterial.
  2. Risk of material misstatement is low as balance is immaterial and even if the balance is misstated, its impact shall be low.
  3. The debtors have a past history of not replying to confirmation letters.
- b) If the auditor intends to send a confirmation, he shall send a positive confirmation because:
1. The auditor is aware of circumstances or conditions that would cause recipients of confirmations to disregard such requests;
  2. A low exception rate is not expected;
  3. The population of items subject to confirmation procedures comprises a small account balances, transactions or conditions
  4. The risk of material misstatement is low.

#### Question no 2

##### a) Fixed Assets

1. Check authorization of purchase to board minutes, capital expenditure budgets and capital expenditure form.
2. Check authorization for disposals of significant assets.
3. Confirm existence of non-current asset register which adequately identifies assets and comments on their current condition. Ensure register reconciles to nominal ledger.
4. Test evidence of reconciliation of register to physical checks of existence and condition of assets.
5. Check authorization of depreciation rates, and particularly changes in rates.
6. Examine evidence of checking of correct calculations of depreciation.

##### Sales

1. Checking numerical sequence of invoices, enquiring into missing numbers and inspecting all copies of cancelled invoices.
2. Scrutinizing credit notes for large or unusual items.
3. Comparing copies of sales invoices and credit notes with the sales day books and sales ledger accounts, checking analysis of sales day books where appropriate and authorization of credit notes.
4. Comparing invoiced prices with authorized, up to date price lists, quotations and correspondence.
5. Checking calculations and additions of invoices and credit notes.

- b) Information required from the bank about 'Bank Accounts' is as follows:

1. Full title of all accounts together with the account numbers and balances therein, including NIL balances:

- I. where the customer's name is the sole name in the title;
- II. where your customer's name is joined with that of other parties;
- III. where the account is in a trade name

#### Notes

- (i) where the amount is subject to any restriction or exchange control considerations, information regarding nature and extent of the restriction should be stated.
  - (ii) Where the authority upon which you are providing this information does not cover any amounts held jointly with other parties, please refer to your customer in order to obtain the requisite authority of the other parties with a copy to us.
2. Full titles and dates of closure of all accounts closed during the period
  3. The separate amounts accrued but not charged or credited as at the above date, of
    - I. Markup/interest; and
    - II. Provisional charges
  4. The amount of markup/interest charged during the period if not specified separately in the customer's statement of account.
  5. Particulars of any written acknowledgement of set-off, either by specific letter of set-off, or incorporated in some other document or security.

#### Question no 3

- a) Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required).

Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

#### Relevance:

Relevance deals with logical connection with the purpose of audit procedures and the assertion under consideration, e.g.

- If purpose of audit procedures is to test for overstatement of an assertion, testing recorded amount will be relevant but if purpose is to test for understatement, testing recorded amount will not be relevant.
- Certain procedures may be relevant for one assertion but not for other, e.g. confirmation evidence may be relevant for existence but not for completeness.

#### Reliability

Reliability is influenced by source and nature and is dependent on individual circumstances; however following general rules are established to determine reliability, i.e. evidence is:

- Reliable if from independent external source.
- Reliable if internal where controls are effective.
- More reliable if directly obtained by auditor than indirectly.
- More reliable if in documentary form than oral.
- More reliable if in original documents than copies.

- 1) ICQs over payroll are as follows:

1. Are the payroll packets checked and reviewed by separate, authorized officers?
2. Are the payroll packets compared against the list of employees before payment commences?
3. Are the payroll accounts reviewed at the start of every month?
4. Are the time cards of employees reviewed by the supervisor?
5. Is the payment of salary above Rs.15,000 made through cheque?
6. Are the cheques crossed before making payment?
7. Is the payment of cash, if any, made after checking employees' data in the employees register and compared against their CNIC?

#### **Question no 4**

The tests of controls which I would suggest to the trainees are as follows:

1. They can carry out sequence test checks on credit notes received, goods received notes and purchase orders and ensure that all items are included and that there are no omissions or duplications.
2. They can check the authorization for the; purchase order, receipt of goods.
3. They can check that control account reconciliations have been performed and reviewed. They can re-perform the control by checking the reconciliation to source documentation.
4. They can check credit notes received and goods received notes to ensure that they are referenced to invoices and purchase orders and vice versa.
5. They can observe that purchase orders are authorized before orders are placed.

**(The End)**